

Internal Revenue Service
memorandum
CC:LM:CTM:SEA: POSTF-169157-01
KGMedleau

Date: JAN 13 2002

To: [REDACTED], Team Coordinator, LMSB: [REDACTED], MS W 133

From: Keith Medleau - Office of Chief Counsel (Seattle)

Subject: [REDACTED] - Carryback of Subsidiaries' Post Acquisition NOLs

Non-Precedential Statement

This memorandum should not be cited as precedent.

This memorandum responds to your December 20, 2001, request for assistance in determining whether an acquired subsidiary's post acquisition net operating losses (NOLs), as well as the post-acquisition NOLs of its subsidiaries, can be carried back to a [REDACTED] consolidated return year in which the subsidiaries were not members of the [REDACTED] consolidated group. As we discussed, because § 338(h)(10) elections were made for the actual and deemed subsidiary stock acquisitions, the NOLs can be carried back.

The rationale and analysis for our conclusions, as well as our understanding of the facts upon which it is based, are set forth below. If the facts are otherwise, please let us know as our conclusions and recommendations could change if the facts are other than as stated below.

FACTS

On [REDACTED], [REDACTED], which files a life insurance/non-life insurance consolidated income tax return, acquired all of the stock of [REDACTED] ([REDACTED]) in a taxable acquisition and a joint § 338(h)(10) election was made to treat the [REDACTED] stock acquisition as an asset acquisition. [REDACTED]'s assets included all of the stock of three property and casualty non-life insurance companies, [REDACTED] ([REDACTED]), [REDACTED] ([REDACTED]) and [REDACTED] ([REDACTED]) and joint § 338(h)(10) elections were made to treat the deemed acquisitions of the [REDACTED], [REDACTED] and [REDACTED] stock as deemed acquisitions of each subsidiary's assets.

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For its [REDACTED] tax year, [REDACTED] reported NOLs of approximately \$[REDACTED] on its consolidated income tax return from its non-life insurance operations, which it elected to carry back to its [REDACTED] tax year and offset against its non-life income for that year. Absent NOLs of approximately \$[REDACTED] from the operations of [REDACTED] (\$[REDACTED] NOL), [REDACTED] (\$[REDACTED] NOL) and [REDACTED] (\$[REDACTED] NOL), [REDACTED]'s non-life operations for [REDACTED] would have generated income of approximately \$[REDACTED].

Exam has asked whether, under Treas. Reg. § 1.1502-21, [REDACTED] is precluded from carrying back the post acquisition NOLs of [REDACTED], [REDACTED] and [REDACTED] to a [REDACTED] consolidated return year in which the subsidiaries were not a members of the [REDACTED] affiliated group.

LAW and ANALYSIS

Under § 172, a corporation incurring an NOL in a taxable year beginning after August 5, 1997, normally may carry the NOL back to each of the two preceding taxable years and forward to each of the 20 following taxable years. Numerous provisions, however, limit the use of a corporation's NOL carrybacks (e.g., §§ 381, 172(b)(1)(E) and the consolidated return regulations) and carryforwards (e.g., §§ 269, 381, 382, 384 and the consolidated return regulations).

Regarding limitations on the ability to carry back certain post-acquisition NOLs of a parent consolidated group (parent), the consolidated return regulations rules concerning NOL carrybacks differ significantly depending on whether corporation (target) generating the NOLs was acquired in a stock or asset acquisition. Where the parent acquired the target stock, whether in a (1) taxable purchase without making any type of § 338 election or (2) tax-free reorganization under § 368, post-acquisition NOLs incurred by the parent group that are attributable to the target can generally be carried back to pre-acquisition tax years of the target (or the target's former consolidated group), but not to pre-acquisition tax years of the parent group. See Treas. Reg. § 1.1502-21T(b)(2)(i) (which, during the years at issue, generally prohibited carrying back into the parent group's pre-acquisition tax years post-acquisition NOLs attributable to the target that could be carried back to target's prior tax years).¹

In contrast, if the parent group acquired the target's assets, whether in a (1) taxable purchase of target's assets, (2) taxable purchase of target's stock with a § 338(g) or § 338(h)(10) joint election or (3) tax-free reorganization under § 368, then the parent group post-acquisition NOLs attributable to the target's former assets generally could be carried back to the parent group pre-acquisition years, but not to pre-acquisition tax years of the target or the target's consolidated group.

In the instant case, the [REDACTED] group made § 338(h)(10) elections to treat its [REDACTED] stock purchase (and the resulting deemed [REDACTED], [REDACTED] and [REDACTED] stock purchases)

¹ The regulation as finalized, Treas. Reg. § 1.1502-21(b)(2)(i), is the same in this regard.

as [REDACTED], [REDACTED], and [REDACTED] asset purchases. By making the § 338(h)(10) elections, [REDACTED], [REDACTED], and [REDACTED] were treated as newly formed corporations of the [REDACTED] group under § 338(a)(2) for all purposes of the Internal Revenue Code, including § 172 and § 1502. As new corporations, [REDACTED], [REDACTED], and [REDACTED] did not have any previous tax years to carry back their post-acquisition NOLs and, thus, their post-acquisition NOLs may be carried back to [REDACTED]'s [REDACTED] tax year. The carryback limitations in Treas. Reg. § 1.1502-21T(b)(2)(i) do not apply because it prohibits the carryback of a target post-acquisition NOLs into the parent's group's pre-acquisition tax years only to the extent the NOL may be carried back to target's prior tax year. As already mentioned, because of the § 338(h)(10) election, there are no targets (i.e., [REDACTED], [REDACTED], and [REDACTED]) prior tax years to carry back the post-acquisition NOLs. See also TAM 8802006 (September 30, 1987) (Service ruled that the post-acquisition NOLs of a target corporation for which a § 338 election had been made may be carried back to the pre-acquisition tax years of the parent affiliated group because the target was considered a newly organized corporation under § 338(a)(2); PLR 8742006 (July 1, 1987) (same as TAM 8802006).

In so concluding, we note that if (instead of buying the [REDACTED] stock) the [REDACTED] group had contributed the consideration it used to buy the [REDACTED] stock to a newly formed subsidiary in order to purchase the assets of [REDACTED] (and the assets of its subsidiaries) directly or if a member of the [REDACTED] group had purchased the [REDACTED] assets (and the assets of its subsidiaries) and contributed the assets to a newly formed subsidiary, the newly formed subsidiary would have been a member of the [REDACTED] consolidated group immediately after its organization. As such, the post-acquisition NOLs of the newly formed subsidiary attributable to the [REDACTED] assets (and the assets of its subsidiaries) could have been carried back to the pre-acquisition years of [REDACTED]'s consolidated group.

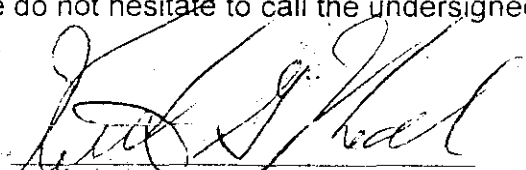
CONCLUSION

Because § 338(h)(10) elections were made for [REDACTED]'s [REDACTED] stock acquisition and the resulting deemed [REDACTED], [REDACTED], and [REDACTED] stock acquisitions, the post-acquisition NOLs of [REDACTED], [REDACTED], and [REDACTED] may be carried back to the [REDACTED] group's [REDACTED] tax year.

Disclosure Statement

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any questions, please do not hesitate to call the undersigned at 220-5951.


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